

Message Text

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ACTION ARA-20

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TAGS: EFIN, BR

SUBJECT: CENTRAL BANK INTERVENTION IN HALLES GROUP
AND ITS IMPACT ON FOREIGN LENDERS

REF: BRASILIA 2691

1. SUMMARY: CENTRAL BANK HAS INFORMED FOREIGN CREDITORS OF HALLES GROUP THAT THEY MAY NOT BE ABLE TO COLLECT ALL THEIR OUTSTANDING LOANS TO THAT INSTITUTION, EVEN THOUGH AT TIME OF INTERVENTION (REFTEL) CENTRAL BANK LET IT BE KNOWN THAT FOREIGN LOANS WOULD BE PAID AS SCHEDULED. APPARENT OBJECTIVE OF CENTRAL BANK IS TO PUNISH THOSE CREDITORS WHO ACQUIESCED IN SOME OF "ILLEGAL" ACTIVITIES OF HALLES. THIS DECISION, HOWEVER, APPEARS TO BE CONTRARY TO ORIGINAL INTENT OF GUIDELINES GOVERNING FOREIGN LOANS TO BRAZILIAN BANKS FOR RELENDING TO LOCAL FIRMS. THERE HAS BEEN SOME SLOWING DOWN OF FOREIGN CREDITS TO THE LESS-KNOWN BRAZILIAN BANKS, BUT THE BALANCE OF PAYMENTS IMPACT SO FAR HAS BEEN MINIMAL. LOANS CONTINUE TO BE CONTRACTED WITH LARGER BANKS AND WITH BLUE CHIP BRAZILIAN FIRMS. END SUMMARY.

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2. REFTEL GAVE REASONS FOR AND BACKGROUND OF CENTRAL BANK INTERVENTION IN HALLES BANKING GROUP, NOTING IN PARTICULAR THAT MONETARY AUTHORITIES WOULD TRY TO PREVENT FINANCIAL REPERCUSSIONS ON BRAZIL'S INTERNATIONAL CREDIT-WORTHINESS. SHORTLY AFTER THE INTERVENTION WAS ANNOUNCED, THE CENTRAL BANK DIRECTOR FOR FOREIGN EXCHANGE GAVE PUBLIC ASSURANCE THAT ALL FOREIGN DEBTS OF HALLES GROUP WOULD BE MET AS SCHEDULED. THIS POSITION WAS PRIVATELY CONFIRMED TO EMBOFFS BY CENTRAL BANK PRESIDENT LIRA.

3. WE HAVE RECENTLY RECEIVED INFORMATION FROM BANKING COMMUNITY TO THE EFFECT THAT FOREIGN LENDERS MAY INDEED INCUR LOSSES SHOULD HALLES GROUP BE LIQUIDATED. TREASURY REPRESENTATIVE RECEIVED CONFIRMATION TO THIS EFFECT FROM RIO AND SAO PAULO BANKING COMMUNITY DURING VISIT TO TWO FINANCIAL CENTERS LAST WEEK. WE ARE SEEKING FURTHER CLARIFICATION FROM THE CENTRAL BANK.

4. APPARENTLY THE CENTRAL BANK RATIONALE IS THE FOLLOWING. IT MAINTAINS THAT SOME FOREIGN LENDERS WERE AWARE THAT LOANS MADE TO HALLES BANKING GROUP FOR PURPOSES OF RELENDING TO LOCAL BORROWERS (RESOLUTION 63 LOANS) WERE NOT IN FACT REPASSED BUT WERE USED TO ALLEVIATE THE TIGHT LIQUIDITY POSITION OF GROUP. AS A RESULT, THE CENTRAL BANK ARGUMENT CONTINUES, THESE FOREIGN LENDERS WHO ACQUIESCED IN SUCH "ILLEGAL" ACTIVITIES SHOULD SUFFER THE CONSEQUENCES. THEREFORE, IT HAS INFORMED FOREIGN BANKERS THAT IT WOULD HONOR ALL FOREIGN LOANS -- SHOULD HALLES BE LIQUIDATED -- AS LONG AS THE ULTIMATE BORROWER CAN BE IDENTIFIED AND THE CRUZEIRO REPAYMENTS RECEIVED. IN THOSE CASES WHERE THE CRUZEIRO RECEIPTS ARE NOT FORTHCOMING BECAUSE GROUP KEPT FOREIGN FUNDS FOR ITS OWN LIQUIDITY NEEDS, FOREIGN LENDERS WOULD NOT BE PAID AS SCHEDULED BUT WILL HAVE TO JOIN OTHER CREDITORS' CLAIM ON HALLES GROUP ASSETS AT TIME OF LIQUIDATION. (HALLES BOOKS ARE SUPPOSED TO PERMIT THE IDENTIFICATION OF ULTIMATE BORROWERS.) IF HALLES GROUP IS IN FACT LIQUIDATED, THEREFORE, SOME FOREIGN LENDERS WILL INCUR LOSSES. ON THE OTHER HAND, IF GROUP IS SOLD TO ANOTHER BANKING GROUP, AND THE CENTRAL BANK HAS BEEN NEGOTIATING ITS SALE WITH A PORTUGUESE BANK, WITH THE UNDERSTANDING THAT NEW MANAGEMENT WILL HONOR ALL EXISTING LIABILITIES, THE PROBLEM OF THESE LIMITED OFFICIAL USE

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LOSSES MAY NEVER ARISE.

5. COMMENT: THE CENTRAL BANK'S DECISION TO INFLICT POSSIBLE LOSSES ON SOME OF HALLES' FOREIGN CREDITORS APPEARS TO BE CONTRARY TO ORIGINAL INTENT OF RESOLUTION 63 LOANS. THAT INTENT WAS TO PLACE AT THE DISPOSAL OF SMALL AND MEDIUM SIZE BRAZILIAN FIRMS THE POOL OF FUNDS AVAILABLE ON THE INTERNATIONAL MONEY MARKET. SINCE THESE FIRMS COULD NOT BORROW DIRECTLY FROM THAT

MARKET, THE BRAZILIAN BANKING SYSTEM WAS TO ACT AS A CONDUIT FOR THESE FUNDS AS WELL AS A GUARANTOR FOR BRAZILIAN BORROWERS. LENDERS NEED NOT WORRY ABOUT THE ULTIMATE BORROWERS BUT WERE TO BE CONCERNED ONLY WITH INTERMEDIATE BANKING INSTITUTIONS. THE CENTRAL BANK, HOWEVER, IS NOW TELLING FOREIGN LENDERS THAT THEY SHOULD IN FACT BE CONCERNED WITH ULTIMATE BORROWERS OF RESOLUTION 63 FUNDS AS WELL AS INTERMEDIATE BANKS. EXPECTEDLY, SOME FOREIGN LENDERS HAVE, SINCE THE HALLES INTERVENTION, REQUESTED THE INTERMEDIATE BRAZILIAN BANK TO SUPPLY THEM WITH LIST OF ULTIMATE BORROWERS OF RESOLUTION 63 FUNDS. WE HAVE BEEN TOLD THAT SOME SUCH REQUESTS HAVE BEEN TURNED DOWN AND THE DEAL NOT CONSUMMATED. ONE AMERICAN BANKER TOLD TREASURY REP THAT MANY SMALL BRAZILIAN BANKS HAVE HESITATED TO SEEK RESOLUTION 63 LOANS FEARING REFUSAL AND POSSIBLE ADVERSE IMPACT ON THEIR CREDIT STANDING. IN ADDITION, THE INTEREST RATE PREMIUM (ABOVE THE LONDON RATE) ON RESOLUTION 63 LOANS HAS BEEN INCREASED AS A RESULT OF THE HALLES INTERVENTION. MOST FOREIGN BANKERS IN BRAZIL BELIEVE THAT INFLOW OF FUNDS UNDER RESOLUTION 63 HAS BEEN SLOWING DOWN FOR THE SMALLER BANKS BUT CONTINUE TO BE CONTRACTED WITH THE LARGER AND BETTER KNOWN BRAZILIAN BANKS. FUNDS ARE ALSO FLOWING IN AT RELATIVELY HIGH RATES UNDER LAW 4131 (DIRECT LOANS TO BRAZILIAN FIRMS). HENCE, THE BALANCE OF PAYMENTS IMPACT OF THE HALLES INTERVENTION HAS SO FAR BEEN MINIMAL (ALTHOUGH WE UNDERSTAND THAT SOME FOREIGN BANKS ARE BEGINNING TO HAVE SECOND THOUGHTS ABOUT COMMITTING FUNDS TO BRAZIL ON 10-YEAR TERMS). IT APPEARS THAT THE MAIN SUFFERERS OF THE LATEST CENTRAL BANK MOVE ARE THE SMALLER BRAZILIAN BANKING INSTITUTIONS, AND THE SMALL AND MEDIUM SIZE BRAZILIAN FIRMS WHICH CANNOT BORROW DIRECTLY ABORAD. IT WAS THESE LATTER FIRMS THAT WERE SUPPOSED TO HAVE BEEN THE BENEFICIARIES OF RESOLUTION 63.

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